REGIONAL EXPERIENCE WITH CONSUMER-BASED HOUSING SUBSIDIES AND AN ASSESSMENT OF THE POTENTIAL FOR HOUSING ALLOWANCES IN SLOVAKIA

Prepared by
Maris Mikelsons

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THE URBAN INSTITUTE
2100 M Street, NW
Washington, DC 20037
(202) 833-7200
www.urban.org

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Background

The concept of a means-tested consumer-based housing subsidy is not unique to Eastern Europe. The first use of a consumer-based housing subsidy dates back to the early 1900s in Europe. Many countries in Latin America have offered grants to poor households for the purchase of new private sector housing. The United States' Department of Housing and Urban development has promoted the use of housing allowances for low-income renters. Today, means-tested consumer-based housing subsidies are increasingly used throughout the world because they have proven to be a relatively efficient and equitable way of providing housing subsidies.

The design of the subsidy can vary a great deal among countries. For example, central and local governments may combine resources to fund a subsidy program or they may separately administer programs. In all the countries, eligibility is determined by means-testing households using either their current income or a combination of income and assets. In some countries the subsidy does not vary in direct proportion with need nor is it available to all tenure groups. Finally, in some countries, the consumer-based subsidy is combined with other forms of housing subsidies such as housing production programs. Table A1 shows the countries that currently administer a means-tested consumer-based housing subsidy.[1]

[A1]- This table shows only those countries that use a direct consumer based subsidy.   By definition, this type of subsidy is payed directly to the household or in some cases to a landlord where the subsidy recipient resides. It is in contrast to production-based subsidies that are linked to the housing unit. We show countries that have documented their experience with a consumer-based housing subsidy.

Regional Experience with Consumer-Based Subsidies

Latin America. Housing assistance in Latin America has evolved along with the broader process of economic reform sweeping this region. Starting with Chile in the early 1980s, many Latin American governments have begun to redefine their role from a direct provider of housing to an enabler of the private sector housing market. Housing subsidy initiatives in Colombia, Costa Rica, El Salvador, Paraguay, and Uruguay follow the "Chilean model".

The Chilean model involves three basic policies that: (1) discontinue direct government production of housing and shift that function to the private sector, (2) provide one-time government capital subsidies to households for the purchase of housing and limit other indirect or implicit government housing subsidies, and (3) institute transparent systems of selecting households that will benefit from government housing subsidies based on current income and a savings contribution. The Latin American programs use rationed (i.e., they are not an entitlement) resources from the central budget and are directed to needy households who do not own a house.

Western Europe.[2] Governments in this region of the world have effectively operated housing allowances for several decades with a wide variety of strategies. Most Western European countries introduced allowances following World War II. The Dutch were the first Western European country to introduce a housing allowance to renter households. In 1930, Sweden introduced an allowance for households with children with the intent of increasing the supply of housing for this group. Thereafter, another Scandinavian country--Finland--introduced a housing allowance. Again, the allowance was designed with the intent to provide adequate housing for large households. By the late 1950s and 1960s, most Western European countries incorporated some form of housing allowance into their national housing policies.

The introduction of allowances was motived by different factors in different countries. As noted above, in Scandinavian countries housing allowances were distributed to impoverished renter households with children. In other countries, governments designed the housing allowance so that it facilitates integration of new (high cost) housing with older (lower cost) rental housing creates enough effective demand to motivate housing developers to build multifamily rental housing. Another important motivation for introducing allowances in Western Europe was to promote labor mobility. This was accomplished because subsidies are paid directly to households allowing them to shop for housing and relocate where employment opportunities exist.

Other Country Experience. In North America, both the United States and Canada use a modified housing allowance to subsidize rental housing. This is also true in Australia. South Africa, on the other hand, recently adopted a Latin American style of housing subsidy to supplement the purchasing power of lower income households and stimulate the private sector to build housing.

The United States has two versions of a housing allowance--certificates and vouchers--that assist renter households. Neither program is an entitlement program, meaning the government funds only a portion of eligible households. For both programs, housing must pass an annual inspection to determine compliance with program quality standards, and the administrative agency must determine that the rent charged by the landlord is reasonable

[A2]- This section of the Annex draws from Jay Howenstine, *Housing Vouchers - A Comparative International Analysis,* Rutgers University Press, New Brunswick, New Jersey, 1986 when compared to similar units in that area.

The certificate program, created in 1974, requires households to pay 30 percent of adjusted income toward their total housing costs and the program pays the difference between the total costs and the tenant's contribution. Adjusted income for this program is gross income less deductions for dependents, excessive medical costs, child care, handicapped person care, and elderly households. Overall, the family contribution represents about 27 percent of gross income. Households must select housing with gross rents at or below a standard set for each market area based upon periodic cost surveys. If the household chooses to lease housing costing less than the standard, less subsidy is required.

The voucher program, initially implemented in 1984, provides a subsidy that is the difference between the cost of standard housing in the area the household chooses to reside and 30 percent of adjusted household income. The household may choose housing that is more or less costly than the standard. If it chooses housing costing more than the standard, it must pay the difference between the subsidy and actual cost; if it chooses housing costing less than the standard cost, the household is allowed to keep the difference.

In recent years, there have been attempts to make the two programs more alike and to consolidate them into one program. In all, there are about 1.4 million households (out of a total 33.5 million renter households) receiving this assistance throughout the country. Another 1.4 million households live in municipally owned subsidized housing. However, the U.S. Department of Housing and Urban Development is considering doing away with most producer-based housing programs and relying on housing allowances as the dominant form of housing assistance in the United States.

Eastern Europe's Recent Experience With Consumer-Based Housing Subsidies

Currently nine Eastern European countries have implemented a consumer-based housing subsidy either on a nationwide or local basis. These include Estonia, Czech Republic, Hungary, Latvia, Lithuania, Poland, Ukraine, and Russia. Slovakia will soon be added to this list. In all cases, the primary motivation for implementing a means-tested housing allowance was to protect poor households from higher housing costs associated with rent increases that generated much needed revenue for the operation and maintenance of housing.

The Czech Republic.[3] The Czech Republic has been slow to initiate reform in the housing sector after the velvet revolution. As in Slovakia, the two cornerstones of socialist housing policy--rent control and strong tenant property rights--remained in place longer than in many Eastern European countries. Although rents for existing municipal units (25 percent of the total housing stock) increased by 100 percent in mid-1992, they still remained below levels needed to cover current operating expenses and support much needed renovation. Realizing that implicit subsidies through rent control were fast accruing in the rental housing stock, the Czech government instituted a rent allowance to compensate for planned rent increases in 1994. In 1996, the government went further with housing reform by implementing a means-tested housing allowance available to all households regardless of tenure.

[A3]- This section of the Annex draws from published and unpublished material. Some of the information for this section came from *The Ten Commandments to the Contribution to Rent,* Ministry of Labor and Social Affairs, Czech Republic. In addition, this section draws upon conversations with Eva Holanova, Director of Income Policy, Ministry of Labor and Social Affairs for the Czech Republic.

Starting in 1994, a rent allowance was made available to all income-eligible households who lived in municipal rental or cooperative housing.[4] The rent supplement was intended to make up the difference between rent increases that took effect in 1994 and existing rent in municipal housing. In designing the rent allowance, the Czech government placed restrictions on participation in the program. Household income could not exceed 1.3 times the poverty line. In addition, a household had to prove it had payed space rent as well as costs for communal services for the previous six months. For the purpose of qualifying for the rent allowance, the average monthly income based on the previous six months was used. In addition to the rent supplement, limits were place on rent increases (40 percent, on average) from their 1993 levels. The rent allowance was also capped for all households (with a lower limit of Kc 50). The allowance was in force for a two-year period.

After one year of experimenting with the rent allowance, participation rates were extremely low due to a combination of factors. First, since the rent supplements were administered by the local social care office, they used the same income verification procedures as were in place for other social programs. This process was rather cumbersome. In addition, the rent supplement was designed so that it was last in the sequence of eligible income sources used to compute the eligibility threshold. Second, the new program was poorly advertised. Brochures were distributed to social care offices but little else was done to announce the new program. In addition, rent increases, and therefore the benefits, were too low for many eligible households to bother applying for the program. The low participation rates translated into low overall program costs. In 1994, out of the central budget allocation of Kc 1 billion for the rent supplement, only Kc 100 million was spent on actual housing expenditures (another Kc 400 million went to administration costs). In 1995, the payout for the supplement increased another Kc 100 million to reach Kc 200 million.

Starting in 1996, the Czech Republic implemented a housing allowance for owners and renters. In part, the government's motivation for introducing a housing allowance reflected the rapid price increases of utilities and rents relative to wages. Over the 1990 and 1994 period, space rents increased by about 180 percent while utilities increased by 420 percent. Wages, on the other hand, increased by only 76 percent. At the end of 1994, rent levels still needed to increase 100 to 600 percent to cover the cost of operating and maintaining public housing.

To save on administrative costs and distribute the benefits equitably--free from local political influence--the housing allowance program was integrated into the existing social safety net. Both renters and owners are eligible for housing allowances, provided their income does not exceed 1.4 multiple of the poverty line. Similar to the rent supplements, renters are eligible if they have paid their previous six months rent while owners are liable for paying property taxes. Household income, including all social benefits received during the previous quarter, is used to determine eligibility.

A complex formula is used to determine the amount of the housing allowance. It uses three parameters to determine eligibility: actual housing costs, the subsistence minimum, and household income.

[A4]- The following discussion centers on renters since the primary purpose of the rent supplement (by definition) was to fill the gap between the rent increase that went into effect in 1994 and existing rent. Cooperative members do not in fact pay "rent" but pay the fixed amortization of the loan used to finance this type of housing. The " rent supplement" for eligible households that live in cooperatives was a flat amount varying only by household size.

$$HA = ZM(h) - \frac{ZM(h) * Y}{ZM * 1.4}$$

Where HA represents the housing allowance; ZM(h) represents the housing cost component of the subsistence minimum; ZM represents the entire subsistence minimum, including housing costs and costs for food and clothing; and Y represents gross household income.

It is useful to rewrite the formula to better interpret its underpinnings. Simply by collecting the terms we arrive at:

$$HA = ZM(h) * [1 - ((1/1.4)*(Y/ZM))]$$

The formula shows that the benefit varies from a maximum equal to the household component of the subsistence minimum (ZM (h)), when income is zero; and a minimum of zero when income is equal to 1.4 times the subsistence minimum. Written in another way, HA = ZM(h) - ß * Y, where ß is equal to [ZM(h) / 1.4 * ZM], the formula resembles the proposed housing allowance for Slovakia, with two major deviations. First, the MSR is now simply the household component of the subsistence minimum, which varies by household size. Second, the benefit reduction rate (in the traditional formula it is the "r") is no longer fixed, rather it varies across households according to their composition, since the subsistence minimum varies according to household size and composition. Based upon this reformulation, the value of ß decreases as the size of the subsistence minimum increases. It ranges from over 0.20 for a single adult to less than 0.10 for large households.

This benefit formula is rather unusual. The most typical design of income-tested benefit programs involves two parameters, the "guarantee" (which in our case would be the MSR), that is, the level of benefits that is guaranteed when income is equal to zero; and the "benefit reduction rate", the rate at which benefits are reduced as income increases (which in the traditional housing allowance formula is the "r"). Together, these two parameters determine the third parameter, the "break-even point"--that is, the level of income at which the household stops being eligible for benefits.

The approach adopted by the Czech Republic reverses this logic, in that the break even point is fixed at a certain multiple of the subsistence minimum, and thus the benefit reduction rate can no longer be fixed. One of the disadvantages of this approach is to render the working of the program less understandable to the public.

Russia.[5] Russia's starting point for housing reform was different from the majority of Eastern European countries with about 70 percent of the housing in state ownership. Accompanying this type of tenure pattern were command-economy practices that contributed to the poor quality and distribution of housing, including centralized construction methods and maintenance practices. Strict rent control applied to all public housing. Similar to other Eastern European countries, Russia quickly divested itself from its housing stock by transferring ownership of housing to municipalities. Secondly, Russia was one of the first countries to pass privatization laws that transferred title to sitting tenants in public housing at little or no cost. Housing privatization was later accompanied by institutional changes that effected the management of multi-family housing units. Following these reforms, municipalities

[A5]- Information about Russia's housing allowance system is found in Ray Struyk and Alexander Puzanov, *Monitoring Russia's Early Experience with Housing Allowances,* The Urban Institute, Moscow, March 1996.

that raised rent were required to implement a housing allowance.

In Russia a system of housing allowances was seen as a way to allow housing service price liberalization while protecting the poorer population from undue economic hardship caused by increases in housing costs. It was also viewed as a means to integrate state rental and the growing private rental sector that was not subject to rent control. With rent decontrol taking place in the public sector, rents would eventually reach parity between to two sectors causing ques for access to public housing to disappear. The magnitude of these reforms were significant since net rent in public housing had not increased since 1928. It was estimated in 1992, that revenue from net rent only covered about 25 to 30 percent of estimated maintenance needs (exclusive of deferred capital costs). In late 1992, the central government authorized municipalities to raise rents and implement a housing allowance program.

Rent liberalization was to take place over five year period allowing for implementation of a housing allowance. This program was the first means-tested program in Russia with program parameters determined at the central level though funding was the responsibility of local governments. The allowance was designed so that it would cover the gap between what a household could afford for housing and what it cost for an appropriately large standard unit. In other words, the Russian housing allowance used the formula (currently under consideration in Slovakia) HA = MSR - r * (Y). The letters MSR in this formula denote the maximum standard rent or housing costs associated with normative floor space standards. While the “r” is a coefficient that determines what a reasonable share of total household income (Y) should be attributed toward housing costs.

Central government officials designed provisions in the housing allowance that allowed for households who were overhoused to have access to smaller units with the assistance of the local governments. Given that the housing allowance formula provides a strong motivation to consume the “right” amount of housing for a given household size (because the MSR varies by household size), drafters of law were concerned that households who live in large units would be relegated to live in housing they could not afford if other (more appropriately sized) housing was unavailable. Therefore, the law mandated that local governments provide “overhoused” households with smaller units should they request to move and exempt these households from paying excess housing costs until another unit was located.

Program administration is done at the local level while some aspects of program design is dictated by the central government. This type of arrangement leads to a great deal of design variation across municipalities. For example, Gorodetz, a city of about 30,000 persons, introduced a design modification to the housing allowance that allowed the parameter “r” in the formula to vary with household income. That is, the lower the income the lower the “r” in the housing allowance formula, starting with 10 percent in the maximum case. This resulted in an increase in the number of households eligible for housing allowances. In another city, Vladimir--a city of about 350,000 people--the housing allowance formula was altered so that it could deduct “special benefits” attributed to invalids, veterans, Chernobyl victims, etc. from the MSR while keeping the benefit reduction rate or “r” in the formula constant at 10 percent. This resulted in reducing the number of households eligible for a housing allowance.

Germany.[6] Shortly, after the integration of East Germany with West Germany a housing allowance was implemented in the former socialist state. This allowance was based on the

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[A6]- Material for this section came from *Wohngeld and Mietenbericht, 1993*, Bundesministerium fur Raumordnung, Bauwesen und Stadtebau, 1994 and personal conversation with Dr. Dick and Dr. Volker.

design of the allowance already in place in West Germany since 1955. East Germany had suffered the same housing problems of other countries with transitional economies including rent control, monopolistic building practices, and highly subsidized state-run management enterprises. The former state housing stock suffered from years of deferred maintenance and housing shortages associated with an arbitrary housing allocation process. Housing services were so inefficient that unsubsidized heating costs were twice as high in former East Germany than on average in West Germany. In addition, compared to West Germany, East Germany used a remarkably higher number of employees to manage and administer comparable multi-family rental housing.

Eligibility for the German housing allowance is determined by a set of tables that take into account income and household size. There is no single formula for calculating the amount of the housing allowance but in theory it is intended to cover the cost of housing that might be socially acceptable. This socially acceptable level is defined by a housing costs to income ratio that on average never exceeds 28 percent. The allowance is based on rent exclusive of utilities and is limited by statutory rent ceilings. The rent ceilings vary due to: family size, local rent level, date of construction, and apartment amenities. The housing allowance is paid directly to the tenant.

By the end of 1992, about 3.8 million household in Germany were receiving a housing allowance. Approximately 1.8 million of these households lived in West Germany, or about 6 percent of all West German households. In former East Germany, approximately 2 million households or 30 percent of all households received housing allowances. By the end of 1993, the number of assisted households in former East Germany dropped to about 1.4 million due to general rise in real incomes associated with the integration process. The cost of the program in 1992 was about DM 6.8 billion, of which about DM 3.1 billion was funded by county governments; the remaining DM 3.7 billion was paid by the federal government. About 10 percent of these costs went to administering the program. In former East Germany, the housing allowance payment represented about 50 percent of all social allowances payments.

In conjunction with the introduction of the housing allowance, rent and utilities in former East Germany increased by 400 percent from 1991 to 1992. Without the allowance, this rent increase would have caused households with low incomes to pay about 30 percent of their income towards housing costs. But with the allowance in place, the average housing cost-to-income ratio dropped to about 20 percent. By 1992, about 31 percent of all tenants were receiving a housing allowance with an average payment of DM 105 per month. The average share of income devoted to housing costs for housing allowance recipients in former East Germany was 18.3 percent while for non-recipients--even with a 400 percent increase in housing costs--the share was only 16.7 percent.

The introduction of a housing allowance combined with other reforms has had a positive impact on afford ability, levels of investment, and household mobility in former East Germany. As early as 1992, the level of investment in the housing sector started to increase, especially among renter households who chose to rehabilitate their housing. In 1993, the number of building permits for rehabilitation increased by about 70 percent over the previous year. Over this same period, new housing starts increased by about 31 percent causing residential construction to be the fastest growing sector in former East Germany. Heating costs (excluded from the housing allowance) have also decreased due to a program of metering individual apartments. Whereas household mobility was stifled in the communist era, survey results show that, in 1993, about 11 percent of all households planned to move within two years while another 9 percent considered it very likely that they would relocate.

Ukraine.[7] Since the Ukraine was part of the former Soviet Union, it housing stock suffered from the same problems associated with socialist provision of housing. Price liberalization has proceeded at a slower pace than in the rest of Eastern Europe. By 1994 housing subsidies amounted to about three-quarters of the national budget deficit. In order to qualify for financial assistance from international agencies, the government agreed to cut subsidies to reduce the budget deficit which had grown to about 20 percent of all government expenditures in 1994. Rapid increases of the price of housing services, including utilities, were necessary to reduce the deficit and increase revenue for much needed housing maintenance and repair.

The design of the Ukraine housing allowance was extremely simple, reflecting the need to implement the program quickly. The housing allowance paid subsidies to households if their total monthly housing payments exceeded 15 percent of their average gross income during the preceding three months. The subsidy was based on a payment structure that allowed 21 square meters per person as a norm in order to avoid paying disproportionately large subsidies to households that lived in apartments larger than the norm. To facilitate income verification, the housing allowance was only paid to those households in which all adults were either working or looking after disabled household members, or were registered as an unemployed worker or student.

With a housing allowance program in place, the government of Ukraine was able to increase prices of housing and utilities to cover about 40 percent of their costs. With lower incomes than generally found elsewhere in Eastern Europe (average of $50 per month), Ukraine households were particularly vulnerable to increases in expenditures for rent and utilities. Without the housing allowances, one half of all households would have had to pay more that 50 percent of their income towards housing costs.

Since the allowance program had to be implemented quickly, the government (assisted by USAID) spent a great deal of resources to set up the apparatus to administer the new social program. About 4,000 new employees were hired and trained over a three-month period using training materials that included a manual and a video. Copies of these materials were distributed to 750 housing allowance offices throughout the Ukraine. In May 1995, these new offices began taking applications for housing allowances and verifying the income of applicants. Office staff used custom computer software to assist with intake and monitoring. In addition, a wide-scale public information campaign was launched using television advertisements, radio commercials, and printed poster boards.

By the fall of 1995, about 800,000 Ukrainian households were receiving housing allowances. This represented about 5 percent of all households; about 6 percent of all households applied for the benefits. About 81 percent of these applicants were from urban portions of the country. The total cost of the program was much less than the government anticipated since its projections were based on 100 percent participation rates among eligible households. The total cost of the program in the first year was $28 million while the budget deficit was reduced by about $600 million due to reductions in subsidies resulting directly from the program of housing allowances.

Other Eastern European Countries. Less information is available about other housing allowance programs in Eastern Europe. Estonia and Lithuania, at one time, utilized a housing allowance that takes into consideration the number of household members and income. The

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[A7]- Information for this section on the Ukrainian system of housing allowances came from Roger Vaughan, *A History and Overview of Ukraine's Housing Subsidy Program,* PADCO, Kiev, Ukraine, November 1995.

allowable share of income spent on housing is higher for higher income households. Rent liberalization has been particularly rapid in these countries despite the fact that their incomes are somewhat lower, on average, than most of the other Eastern European countries.

Poland introduced a housing allowance in 1995. Survey data there show that a large share of the richest urban households occupy rent-controlled housing. New rental legislation will allow rents to rise to cover the full cost of operating and maintaining housing. As of 1995, rents only covered about 35 percent of operation and maintenance costs. Public and private housing renters and cooperative owners are eligible for allowances. Income eligibility for the new allowance is set at the pension level and the maximum share of income devoted to housing varies by household size (i.e., 15 percent for single person households, 12 percent for 2 to 4 person households, and 10 percent for all other households).

Although Hungary does not have a nationwide housing allowance program, localities implement housing allowance programs. With USAID technical assistance, the city of Szolnok implemented a housing allowance program. The city increased rents, introduced housing allowances, and reformed its municipal housing management practices. The design of the housing allowance was based on the same formula proposed for Slovakia, that is, the allowance covered the gap between what a household could afford and the normative cost of standard quality housing. The city set the maximum share of income devoted toward housing cost at 35 percent of gross income. For renters, the maximum standard rent included space rent and utility costs. For homeowners, there was a separate utility allowance with an additional subsidy to cover mortgage payments. Less than half of all eligible households participate in the housing allowance program. About 42 percent of all eligible households participated in the program during the first two years.

HOUSING ALLOWANCES : ASSESSING THE POTENTIAL FOR SLOVAKIA

Rental housing in Slovakia is currently owned and operated by municipalities which abide by a national law that sets fixed rent rates for units according to dwelling size. As a consequence, a low-income household pays exactly the same rent as a high-income family for a comparable rental unit. In addition, due to extremely strong tenant rights and a system of planned housing production, households in Slovakia cannot easily move from one unit to another. Because of this constraint on mobility, there is often no relationship among a household's size, the size of the unit it occupies, and the household's income. Furthermore, because of low and highly subsidized rents, the housing stock in Slovakia suffers from years of deferred maintenance. In addition, because of price liberalization, utilities or energy costs associated with housing now constitute the major share of housing costs and in some cases, severely impact on family budgets.

In order to right these inequities and inefficiencies in the housing sector and promote market-oriented housing production, a formula-based housing allowance is needed. In general, a formula-based housing allowance system requires participants to pay a fixed share of their income for rent. The allowance fills the gap between this share of income and the rent (including energy or utility costs) for an appropriately sized housing unit of good quality. Under this scheme, a household is free to rent private as well as public housing since the allowance payment is paid directly to the family and can be used to cover housing costs regardless of who owns the unit or tenure form. By implementing this type of housing allowance in conjunction with increasing rent for public units and decontrolling rents for private rentals, Slovakia will be able to initiate housing sector reforms while protecting poor members of society from having to pay an excessive amount of income for housing.

The size of a housing allowance is determined by a household's income, the applicable maximum standard rent (or energy, utility, or other housing cost), and a predetermined maximum share of income devoted to housing costs. Analytically and administratively, formula-based allowances can be based on *total* housing costs, including utility payments. This type of allowance provides behavioral incentives for a more efficient and equitable distribution of housing based on market principals. The formula for computing the housing allowance (*A*) is given by:

$$A = MSR - (r * Y)$$

The right hand side of the equation determines the amount of the allowance. The maximum standard rent (cost) *MSR* is set according to social norm of housing need based on the size or characteristics of a family. Under this scheme, a floor space allowance could be set for families of different compositions and then multiplied by the different components of housing valued on a square meter basis (m2). The space allowance could be established according to family composition, taking into account the number, age, and family relationships. The *MSR* can be defined to include maintenance fees, rent, energy costs or some combination The argument for including energy costs is that currently these make-up the larger share of housing expenditure for many owner and renter families.

In the above equation, ***r*** is the share of income a household can reasonably be expected to spend for housing. Currently, households renting in Slovakia spend about only 5 percent of their income towards base rent alone. According to the most recent Family Budget and Expenditure survey, households in Slovakia, overall, spend about 12 to 13 percent of their family budget on housing related expenditures. This compares to about 25 to 30 percent in Western Europe and America. The ***r*** in the housing allowance formula for Slovakia could be set according to information derived from surveys such as the Family Budget and Expenditure survey. Since few families live in units that are exactly the same size as the social norm, families rarely will pay exactly the percentage of their gross income chosen for ***r.***

In the equation, ***Y*** is the households monthly income from all sources. Allowance payments equal the ***MSR*** when the household has no income and therefore the allowance payment declines as income rises. Thus allowances are phased out or discontinued when ***Y = MSR/r***. This method of calculating a housing allowance payment is better than if it were based on whether a household's income is above or below some arbitrary income cutoff as is the case in the Czech Republic. Notice, the ***MSR*** is set according to norms for size of the unit and related housing costs and not according to the <u>actual</u> size or <u>current</u> housing related expenditures.

In market-based economies where formula-based allowances are utilized, the *MSR* is set according to market rents, and is set high enough to provide a household with the ability to lease a good quality unit. The household may lease a unit for more than the *MSR*, but the difference must be paid by the household. If the allowance exceeds the actual rent, the households can keep the difference. However, the household might be required to pay a minimum share of their income towards housing costs in order to participate in the program, thereby providing some incentive for households to choose a minimally adequate housing unit. The behavior incentives built into the formula motivate households to purchase or pay for the amount of housing or housing related goods such as energy, that is appropriate to its characteristics.

Historical Overview

The first use of the consumer-based housing subsidy, such as the housing allowance, dates back to the early 1900s in Europe. The Dutch first introduced a housing allowance to families displaced by slums during the first war. Some years later, Sweden introduced its first consumer-based subsidy to families with children as way of making more housing available to the poorer segment of society. Shortly thereafter, another Scandinavian country - Finland - introduced a housing allowance that was made available to large families only. By the late 1950s and 1960s, a housing allowance had been incorporated into national housing policy of the majority of Western European countries.

The introduction of housing allowances has been motivated by different factors in various countries. The earliest development of the housing allowance was motivated by the need to protect large families and the elderly from undue economic hardship (Scandinavia). In other cases the housing allowance was used in a pragmatic attempt to integrate new high cost housing with the older low cost rental housing, providing families with the incentive to move into new housing that might otherwise remain vacant or never built in the first place. Another important motivation for introducing the housing allowance in European countries was to promote labor mobility required by changing economic growth areas. (This especially true in Slovakia - a country undergoing major structural change during its transition from a command economy to one more orientated towards markets.)

More recently, housing allowances have become the dominate form of subsidizing housing because of cost considerations.   Many countries are turning away from producer-based subsidies due to the systems high per-family cost relative to consumer-based subsidy such as the housing allowance. In France, Sweden, and Germany the dominate form of housing assistance is based on a housing allowance. Overall in Western Europe, the extent of housing allowance programs is large; in four countries approximately one-fifth or more of all households receive some form of a housing allowance and in three additional countries it is approximately one-tenth. The United States is currently considering collapsing its dominate producer-based housing programs into a single housing allowance program thereby expanding the coverage of its existing housing allowance to include even more families.

In Eastern Europe, six countries (Lithuania, Estonia, Latvia, Slovenia, Poland and the Czech Republic) use a modified housing allowance on a national scale to protect a growing pool of low-income households, increase revenues for operating and maintaining rental housing, and promote the production of new housing. In the Russian Federation, a housing allowance system has been successfully adopted by specific cities, such as Moscow. Since the joining of East and West Germany, the West Germany housing allowance scheme was adopted in the New Lander. There the program has been extremely successful in improving housing conditions and creating a good deal of economic activity associated with increases in demand for housing and related housing goods.

If implemented, similar to the experiences of other East European countries, a formula-based housing allowance scheme for Slovakia will address six main policy objectives:

- protect low-income households from paying an excessive share of their income for housing;

- integrate government-owned and private rental housing in such a manner that households are free to locate from one type of housing to another without incurring excessive costs;

- use the price mechanism as a signal to allocate housing and housing services thereby, eventually, doing away with rent control and subsidies for utilities and energy costs;

- eliminate producer-based subsidies which have led to inefficient consumption of housing since in many cases housing unit size does not correspond with the size of the family;

- raise revenue for much needed building maintenance of the rental housing stock by allowing rent to increase without imposing undue hardship on low-income families; and

- stimulate the production of good quality housing by increasing the ability and willingness of households to pay for housing and utilities costs.

Rental Housing Subsidies

Revenues from rent payments for public housing have never fully covered operating, maintenance, and capital costs. In the past, the state made up the shortfall in rental revenues but the subsidy was often inadequate to cover the costs associated with public housing.[----] In 1990, the last year that the state subsidy fully covered the gap between operating costs and rental income, the total subsidy for Slovakia amounted to Kčs 1.6 billion. Since then, ownership of public housing has been given to the municipalities, and they are now responsible for the subsidy. Accurate figures on the total subsidy paid since then are not available but it is likely (given constraints on local revenues) that operating and maintenance outlays have fallen behind the inadequate levels of 1990.[aaaaa]

The extent of housing subsidies accruing to municipalities and attributed to operating and maintaining rental housing is best illustrated by an example drawn from a typical municipality. In Bratislava's District 4 there are about 3,500 municipal rental housing units as of mid-1993, managed by a (private) housing management company for a fixed fee of Sk 60 per unit per month. This management fee is paid directly out of the District's general operating revenues which, in turn, are supplemented by rent payments collected from the tenants on a monthly basis. If rent, on average, for these units is Sk 320 per month (based on an average size category I unit), then total rent, less actual arrears of 2 percent, is approximately Sk 1.1 million per month. The monthly fee for managing the units, based on Sk 60 per unit, is Sk 210,000. Assuming the true economic cost of managing and operating the units is equal to four times current rent revenues[-----], the implicit subsidy is about Sk 3.4 million per month. This sum represents the difference between what is needed and what is actually collected on a monthly basis. Given increasing losses from the municipal revenue base due to restructuring and the loss of state transfers to municipalities in 1993 for housing, the District's need for additional revenues for the operation and maintenance of housing accumulates over time causing the condition of the buildings to deteriorate.

Since rents are still regulated while subsidies for energy costs have almost been eliminated, utility charges constitute a significant share of total housing costs. Along with the general price liberalization initiated in 1991, subsidies for utilities have been gradually relaxed. Starting in 1992 price controls for electricity, heat, and other fuels (mainly used for heating and cooking) were partially lifted. At the beginning of 1993, price controls for electricity, gas, and other fuels for residential housing were all but lifted. This left heating as the only commodity still explicitly subsidized by the state budget. In 1993, the Republic's budget allocated Sk 2.24 billion as a subsidy for heating costs, mainly going to producers of heating. Today, utility or energy payments make up well over 50 percent of housing costs for renter and owner households. As a result, there is strong need to evaluate whether a housing allowance should include utility or energy costs as part of the formula.

The second group of renters are represented by the affordable rent curve which is above the vertical line based on the average rent-to-income ratio. These households or about 63 percent of all municipal renters, pay less than their affordable rent. For them, their

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Between the years 1964 and 1991, rents (with the exception of cooperatives) did not change despite the fact that operation and management losses accumulated. Today, government estimates of neglected housing maintenance amount to Sk 40 billion or Sk 90,000 per unit.

In January 1992, service charges for municipal units were increased by about 200 percent. Combined with the base rent for a municipal unit, this represented an increase of about 80 percent over the previous level (concurrently, rent discounts based on the number of children were abolished). In July 1992, base rents for municipal housing were doubled.

The Association of Housing Management Companies estimates that rents would need to rise by anywhere between 400 to 600 percent to cover the costs of operating and maintaining housing units.

income would allow them to pay more but since rents are strictly controlled, they accrue a windfall at the expense of those who pay more than their affordable rent. With rent control, revenues from rents fall short of the costs to operate and maintain buildings. However, according to the affordable rent curve there is a group of renters who could pay more but instead receive a subsidy. Combined this subsidy accrues to renters at about Sk 40 mil. per month or almost Sk. 500 bil. a year.

There are indications that income disparities among households in Slovakia are growing. The affordable rent curve in Figure 1 shows conditions in early 1993. If truly the poor are growing poorer and the rich are getting richer, the amount of subsidy accruing to those renters falling above the average rent-to-income line would increase. Graphically, this would cause our affordable rent curve to rotate on its axis where it touches the rent line (assuming rent control was still in place). The negative gap for those households below the rent line would also widen.

This illustration shows that a good portion of renters receive a subsidy through imposition of rent control at the expense of other lower income renters. Because of rent control municipalities are forced to subsidize the operation and maintenance of their housing. The current policy of fixed rent for housing irrespective of the ability of the household to afford this their monthly payment clearly is inequitable. The solution to a policy that allows tenants who in fact have the ability to pay more for housing to accrue a subsidy and does not afford protection to those households who need assistance with their housing costs is implementation of a housing allowance.

Slovakia's Social Safety Net

Similar to other Eastern European countries, Slovakia has an extensive system of government cash transfers designed to aid needy individuals and households. Slovakia's safety net is currently divided into three major categories: (1) social security, (2) social welfare, and (3) unemployment. Combined, these programs offer a wide array of benefits. Today, the government is reforming the social benefits programs to function better in a market-based economy. The proposed housing allowance could replace the housing component of the current social welfare benefit.

In response to the changing fiscal demands placed on the social safety net in a country undergoing major structural change, Slovakia's Ministry of Labor and Social Affairs began to modify the benefits program in 1992. The Ministry streamlined the funding mechanisms of various programs and attempted to target benefits more efficiently. In addition, the National Insurance Company was established to manage three social security funds: health care; sickness insurance; and pensions. A fourth fund was also established to manage unemployment benefits.

The government has proposed other modifications to the social safety net. It seeks to consolidate many overlapping programs while redefining others to be more inclusive of individual and family needs. There are three main components to the new system of benefits: (1) social insurance, including health insurance and pensions; (2) state social support, including child allowances, parenthood allowances, and housing allowances; and (3) state social assistance, including programs to benefit the poorest citizens. (While the unemployment benefit will be retained, this program is distinct from the three managed by the Ministry.)

While the three proposed categories of assistance retain many of the current programs, a major distinction from the current system is found in the newly proposed social support category. The social support programs will become means-tested with an income eligibility threshold of either 1.5 or 2 times the established poverty level. The new proposed social support package also includes such programs as; child allowances, payments for incomplete families, parenthood allowance, birth grant, personal assistance for disabled, disability payments, and housing allowances.

Currently, the structure of the housing allowance component of the newly proposed state social support category is being debated. One issue centers around whether to make owners and renters eligible for housing assistance. Another issue focuses on whether utilities should be included in the calculation of the housing allowance and whether or not to base the allowance on a housing quality standard similar to the one used by the *MSR* in formula-based housing allowances. The proposals calls for housing allowances to be income based, though whether the payment is directed to the manager of the housing, the owner, or tenant is still being debated. Furthermore, local governments have been proposed as the administrators of the allowance, though program parameters such as the ***MSR*** or ***r*** would be set at the national level.

Conclusions and Recommendations

Political acceptance of rent increases large enough to approximate market levels and provide resources for adequate housing operation and maintenance is unlikely without a formula-based housing program. A housing allowance program undermines the argument that the poor cannot afford to pay such high rents. Under the housing allowance system, low-income households would be protected since no one would have to pay more than a fixed share of their income for rent. Only middle-income and high-income tenants of communal housing (and there are many of these) would have to pay substantially more out of their own pockets than they are paying at present. A housing allowance program is, therefore, the key to political acceptance of rent increases which, in turn, will be essential if an adequately maintained and managed housing stock is ever to be a reality in Slovakia.

With the technical assistance of USAID the Ministry of Labor and Social Affairs has used the housing allowance and income support (HAIS) model to simulate the impact of a housing allowance scheme in Slovakia. This model was designed specifically for Slovakia so that the number and type of eligible beneficiaries could be estimated under different program designs and parameters. The HAIS model also estimates the amount of the housing allowance (Sk) payable to household. The data the model uses is based on an updated MikroCensus file statistically matched with the Family Budget and Expenditure survey supplied by the National Statistics Office.

According to the simulation results form the HAIS model, the estimated annual housing allowance outlay required to protect the poor in cooperatives as well as in rental housing, associated with a 100 percent rent increase and a maximum 20 percent share of income devoted to housing (***r*** in the formula) expenditures in 1993, was only Sk 64 million per month. This is less than half of the actual state subsidy paid for state rental housing in 1990. For municipal unit renters only, the HAIS model estimated that monthly allowance outlays would total Sk 34 million or Sk 408 million a year. Even with a 400 percent rent increase, only 50 percent of all municipal and cooperative tenants with an average Sk 562 per month allowance would be eligible for the program. Under this scenario, base rent levels four time higher than they are today would approximate true cost of operating and maintaining apartment units.

The housing allowance concept is already built into the social support component of the draft social safety net proposals being reviewed by the Ministry of Labor and Social

Affairs. What has worked in other countries is housing allowance program that is a separate and clearly identifiable component of social support, rather than being buried in an indistinguishable general payment. The type of housing allowance appropriate to the conditions of Slovakia needs to be evaluated but from all indications from other country experience the allowance should be a based on the difference between the household's ability to pay a reasonable share of its total gross income towards housing costs (including utilities or energy costs) and what it costs to rent a good quality unit appropriate to the size of the household.   The allowance would not have to be limited to renter households but they should be paid directly to the households since this will allow households to “shop” for housing appropriate to their particular circumstances and allow for much needed labor mobility. The political support necessary for base rent increases will only be forthcoming if a formula-based housing allowance is implemented.